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C O N F I D E N T I A L SECTION 01 OF 02 MOSCOW 004932

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DEPT FOR EUR/RUS, FOR EEB/ESC/IEC GALLOGLY AND WRIGHT
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TAGS: EPET ENRG ECON PREL RS
SUBJECT: WINTER CUTOFFS OF RUSSIAN GAS LESS LIKELY THIS YEAR

REF: A. MOSCOW 3777

¶B. 06 MOSCOW 13174
¶C. 06 MOSCOW 546
¶D. 06 MOSCOW 0084

Classified By: Ambassador William J. Burns for Reasons 1.4 (b/d)

SUMMARY

¶1. (C) Despite the noise created by the press, Russia seems to have learned from the PR blunder of shutting off gas to Ukraine in the winter of 2006 (ref D) and we expect a relatively quiet winter this year with respect to gas supplies. The immediate resolution of the recent mini-dispute over an accruing debt for gas deliveries is indicative of the scenario we can expect this winter between Russia and Ukraine -- public posturing, followed by private negotiations and agreement, and continued gas flows. The situation was similar to one this summer with Belarus (ref A), which ended with no disruptions and payment by Belarus of its arrears. As Georgia now gets most of its gas from Azerbaijan and pays European prices for Russian gas, it should not face the usual tensions. End summary.

OVERVIEW

¶2. (C) Gazprom,s director of international affairs, Ivan Zolotov, told us recently that he does not foresee any problems with gas supplies this winter to or through any transit states. Several analysts with whom we spoke agreed. Cambridge Energy Research Associates (CERA) research director Vitaly Yermakov told us October 5 that he does not see much risk of supply reductions, despite any political tensions. He added that adequate physical supplies, given ample storage by Gazprom due to mild temperatures last winter, should also help ease tensions, even if demand spikes. These points are reiterated by several investment houses in Moscow who view the potential impact of such incidents on Gazprom's bottom line with a microscope.

UKRAINE - Who Owes Money to Whom?

¶3. (SBU) Gazprom issued a tersely worded press release on October 2nd suggesting it would reduce supplies to Ukraine "in case of debt non-repayment." Gazprom claimed that Ukraine owes $1.3 billion for gas deliveries. As dozens of press articles ran with titles such as "Gazprom to cutoff gas to Ukraine," Ukrainian Energy Minister Boyko was in Moscow successfully negotiating an end to the dispute. On October 3 Gazprom announced the debt issue had been resolved, and First Deputy Prime Minister and Gazprom Chairman Dmitri Medvedev told the press the two sides "had reached an agreement to avoid such problems in the future."

¶4. (C) Ukrainian Embassy First Secretary Yaroslav Dubovich confirmed to us privately October 4th that the Ukrainian side will pay what it owes by November 1, after which the 2008 price negotiations would begin in earnest. The murky nature of the intermediaries who transport gas to Ukraine (largely from Turkmenistan) was highlighted by Dubovich's inability, despite repeated direct questions, to clarify who actually owes money to whom. Dubovich finally just smiled and admitted the question is difficult to answer.

¶5. (C) Dubovich theorized Gazprom timed its statement to make it difficult for the new Ukrainian government to avoid repayment. He added that Gazprom wants to lay blame on Ukraine in case of any disruptions to European supplies transiting the country. He stressed, however, that Ukraine "guarantees" that all gas intended for Europe will transit uninterrupted. He also emphasized that there would be no supply disruptions of any kind.

¶6. (C) Dubovich did admit concern that Gazprom's attempts to secure a share of Ukraine,s internal gas distribution and its transit system may lead Gazprom to maintain relatively

low prices as leverage to gain the assets. But he also said he thought the "correct" netback price Ukraine should pay is about $170-$185 per thousand cubic meters, not radically higher than current prices. (Note: he also pointedly asked whether we could interest an American company in playing a part in an international consortium to run the transit system. End Note).

BELARUS - Lookin' for Cheap Gas

¶7. (SBU) The situation this week with Ukraine was similar to one this summer with Belarus -- Gazprom announced that Belarus owed some $500 million and threatened a cutoff, both sides publicly blustered, Belarus agreed to pay, and the situation was resolved.

¶8. (SBU) Belarus's general circumstances, however, are different. Russia relies on transit through Ukraine for some 75-80% of its gas exports to Europe vs. about 20% through Belarus. Belarus is also much more dependent economically on subsidized gas, and pays the lowest prices among the FSU countries. Furthermore, as Dubovich said, "Belarus's issue is that it doesn't want to pay," as opposed to the political disputes that have characterized Russian-Ukrainian relations.

¶9. (SBU) The resolution of the Belarus debt this summer, the sale to Gazprom of half its distribution network (Beltransgaz) as part of a 2006 agreement, and Russia's more cooperative stance, make potential supply disruptions to and through Belarus this winter unlikely. Negotiations, however, may go down to the wire, as they did last year (ref B).

GEORGIA - Paying European Prices

¶10. (SBU) While Georgia continues to be a major political irritant for the Kremlin, it is no longer at much risk for

gas supply disruptions. Following last year's row over gas with Russia (ref C), Georgia now gets most of its gas from Azerbaijan and pays European prices for the gas it receives from Russia, thus effectively isolating it from the Russian pressure.

COMMENT

¶11. (C) Gas supplies, routes, and interdependency will continue to be major factors in relations between Russia, Ukraine, and Belarus. While Russia's dependency on these transit states will likely diminish as it pursues export route diversification, it will not disappear any time soon. Nor will Ukraine's and Belarus's dependence on Russian gas and hopes for discounted prices. This winter we expect some continued tension over prices, some public back-and-forth between political leaders, and, in the end, negotiated settlements that prevent any reductions in gas deliveries. Ukraine's price of $130 per thousand cubic meters of gas will likely rise, but not to Western European levels. Belarus's price will rise but not to Ukrainian levels.

¶12. (C) With elections in Russia causing some political uncertainty and Russia's reliability as an energy supplier under scrutiny by the EU and others, the Kremlin will likely try to avoid increasing concerns about its role in regional and global energy markets. That does not, however, rule out the potential for political developments in any of these countries, or further arrears, leading to public spats. End comment.
Burns